STATE OF CALIFORNIA

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE

SAN FRANCISCO, CA 94102-3298

November 17, 2003

Agenda #2978
Ratesetting

TO: PARTIES OF RECORD IN APPLICATION 02-11-048

This is the proposed decision of Administrative Law Judge (ALJ) Grau, previously designated as the principal hearing officer in this proceeding. It will not appear on the Commission's agenda for at least 30 days after the date it is mailed. This matter was categorized as ratesetting and is subject to Pub. Util. Code § 1701.3(c). Pursuant to Resolution ALJ-180 a Ratesetting Deliberative Meeting to consider this matter may be held upon the request of any Commissioner. If that occurs, the Commission will prepare and mail an agenda for the Ratesetting Deliberative Meeting 10 days before hand, and will advise the parties of this fact, and of the related ex parte communications prohibition period.

The Commission may act at the regular meeting, or it may postpone action until later. If action is postponed, the Commission will announce whether and when there will be a further prohibition on communications.

When the Commission acts on the proposed decision, it may adopt all or part of it as written, amend or modify it, or set it aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Parties to the proceeding may file comments on the proposed decision as provided in Article 19 of the Commission's "Rules of Practice and Procedure." These rules are accessible on the Commission's website at http://www.cpuc.ca.gov. Pursuant to Rule 77.3 opening comments shall not exceed 15 pages. Finally, comments must be served separately on the ALJ and the assigned Commissioner, and for that purpose I suggest hand delivery, overnight mail, or other expeditious method of service.

/s/ ANGELA K. MINKIN
Angela K. Minkin
Administrative Law Judge

AKM:hf1

Attachment

Decision **PROPOSED DECISIONOF ALJ GRAU** **(Mailed 11/17/2003)**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Great Oaks Water Company (U 162-W) for an Order authorizing it to increase rates for water service for its total service area by $2,811,000 or 35.5% in the year 2003; by $978,000 or 9.0% in the year 2004; and by $978,000 or 9.0% in the year 2005; and by $978,000 or 9.0% in the year 2006.	Application 02-11-048 (Filed November 27, 2002)

Lenard G. Weiss, Attorney at Law,
and Christine H. Jun, Attorney at Law,
for Great Oaks Water Company, applicant.
Charlyn A. Hook, Attorney at Law,
for the Commission's Office of Ratepayer Advocates, protestant.

OPINION RESOLVING GENERAL RATE CASE

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1. Summary

Great Oaks Water Company (Great Oaks) is authorized a $482,054 revenue increase for total company operations for 2003, $737 for 2004, and no increase for 2005 and 2006. We approve the Santa Teresa Project and related expenditures, $1,838,000 for 2003 and $1,061,000 for 2004, subject to Great Oaks filing an advice letter when the project is placed in service. In 2003, a residential customer with 5/8 x ¾-inch metered service using 20 Ccf will pay $34.57 instead of the present rate of $33.80, a 2.26% increase. Rates will not increase in 2004.

2. Background

Great Oaks filed this General Rate Case (GRC) application for the total company on November 27, 2002. Resolution ALJ 176-3102 preliminarily categorized this proceeding as ratesetting and determined that hearings were necessary. The Commission's Office of Ratepayer Advocates (ORA) filed a protest on December 23, 2002, objecting to the overall size of the proposed increase. Assigned Commissioner Geoffrey F. Brown's February 10, 2003 Scoping Memo confirmed the category and need for hearing, set the scope of the proceeding, and established a schedule.

Great Oaks serves approximately 20,138 customers in a service territory covering roughly twenty-four square miles in Santa Clara County. Great Oaks is a privately held water corporation owned by the Roeder family. Great Oaks' application requests the overall rate increases shown in Appendix A, Table 1. In addition, Great Oaks seeks Commission approval of $2,647,000 in balancing memorandum account undercollections by a usage surcharge to be effective for 36 months. Great Oaks last filed a GRC in 1992.

Great Oaks modified its GRC request to propose a 10.56% return on equity, which it estimates would produce 9.42% and 9.73% rates of return on rate base for Test Years (TY) 2003 and 2004.

A prehearing conference was held on January 22, 2003. On January 27, 2003, Great Oaks filed a request for an interim surcharge subject to refund of $1,042,881 to permit recovery of increasing groundwater charges and purchased power costs. ORA filed a motion to suspend the proceeding on March 3, 2003, because Great Oaks did not provide timely notice to its customers of the requested rate relief. ORA filed a motion to dismiss Great Oaks' application on March 7, 2003 for failure to make a prima facie case in its application. On March 19, 2003 the assigned Administrative Law Judge (ALJ) denied Great Oaks' request for a surcharge and ORA's motions to suspend and dismiss. Four days of evidentiary hearings were held from March 17 through 20, 2003.[1] The parties filed a comparison exhibit and comments on April 10. The proceeding was submitted upon receipt of concurrent briefs on May 12, 2003. On September 30, 2003, the assigned ALJ ordered the parties to update the comparison exhibit. The update was provided on October 16, 2003.

3. Discussion

We affirm the assigned ALJ's ruling denying Great Oaks' surcharge request and ORA's motions to suspend and dismiss. Great Oaks and ORA agree on many results of operations figures. In general, we find those amounts reasonable and adopt them.

a. Burden of Proof

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[1] The hearing commenced on March 17 but recessed until March 18 to permit parties to participate in mediated settlement discussions.

ORA alleges that Great Oaks did not meet its burden of proof to justify its proposed rate increase, because Great Oaks responded tardily to data requests, filed rebuttal testimony just prior to the hearings, and supplied additional information during mid-hearing mediation and post hearing. ORA recommends that the Commission deny rate requests Great Oaks did not justify in its affirmative showing. ORA contends that Great Oaks has failed to meet its burden to justify all of its requested plant additions and estimates for ratebase. In addition, ORA alleges that Great Oaks has not properly recorded expenses related to litigation regarding contamination. The applicant in a rate case, not Commission staff, bears the burden of proof to establish all necessary facts which would justify the requested increase in rates.

b. Customers' Concerns

The Commission's Public Advisor's Office received a total of fourteen letters and e-mails from Great Oaks' customers between March 9 and April 6, 2003 in response to Great Oaks' proposed rate increase. The overwhelming majority of those customers opposed the size of the requested increase as being excessive in relation to the increase in costs. Two customers objected to the increases as failing to support conservation efforts. We will consider this input in reaching our decision on Great Oaks' revenue increase request.

c. Results of Operations

The Great Oaks-proposed, ORA-proposed, and adopted results of operations are shown in Appendix A. Appendix B contains tariff schedules; Appendix C provides bill comparisons for present, 2003 and 2004 rates; Appendix D contains adopted quantities, rate base, and income taxes; and Appendix E contains attrition rates.

(1) Operating Expenses

(a) Payroll

Great Oaks requests $630,000 for management payroll for TY 2003 and $680,000 for TY 2004. ORA recommends $340,117 for TY 2003 and $347,940 for TY 2004, a net reduction in management payroll expense. Great Oaks has three management employees and twelve field and office employees and will add two field employees in 2003.

Great Oaks' and ORA's salary studies support their differing estimates. Great Oaks' study incorporated salary data from geographically relevant water companies, such as the Santa Clara Valley Water District, City of San Jose Municipal Water Company, Alameda County Water District, San Jose Water Company, and East Bay MUD. (Exhibit 13.) Great Oaks states its management salaries lag behind the other companies' salaries, and that it lost a senior manager due to the level of compensation. (*Id.*)

ORA based its recommendations on a 2001 study by the American Water Works Association (AWWA), which includes salary information from the Southeast and Southern United States. (Exhibit 21.) ORA states the study shows that Great Oaks' managers earn 37.7% more than managers with comparable positions at other utilities. Great Oaks contends that study never was meant to be the sole basis for designing salaries and offers a letter from the project manager of the AWWA survey to that effect. (Exhibit 13.)

Great Oaks and ORA also disagree on the increase in office and field payroll expense for TY 2004.[2] Great Oaks requests $979,500, a 22% increase.

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[2] ORA agrees with Great Oaks' TY 2003 estimate for office and field payroll expense, $804,000.

ORA recommends an increase using ORA's factor of inflation, $822,492, stating Great Oaks has not justified the larger increase. Great Oaks states that the TY 2004 increase includes the second year of salary increases for field and office employees, as indicated by its salary study, that there is high turnover in field personnel, and that field and office personnel are recruited by other companies, some for executive positions. (Exhibit 13.) Great Oaks considered different elements for each field position, because Great Oaks' field personnel had broader responsibilities than did comparable personnel in other companies. Great Oaks alleges that ORA's recommended disallowance is based on a San Jose Water Company union contract for non-management positions.

Employee retention is a laudable goal in order to ensure the high rate of customer satisfaction that ORA agrees Great Oaks maintains. Under the circumstances, reducing management payroll would be inadvisable. In addition, Great Oaks has pointed out certain deficiencies in ORA's management compensation study. However, Great Oaks' salary study for field and office personnel lists comparative compensation based on function, elements, and compensation from multiple positions, sometimes two to four, where Great Oaks deemed it impossible to use an effective average. Great Oaks has not demonstrated the soundness of its proposed methodology in addressing the perceived need, employee retention, especially where employees have been offered executive positions. Comparable compensation, not composite compensation, is most helpful and less subjective.

Thus, we decline to approve Great Oaks' full request. We will approve Great Oaks' management payroll expense for TY 2003, in conformance with the agreed-to increase for office and field expense. This substantial increase in payroll expense should ensure retention of both management, field, and office personnel.[2] We will approve ORA's inflation factor for TY 2004 (approximately 2.3%) for management and office and field payroll expense.

(b) Groundwater Charges

Great Oaks and ORA agree on the original estimates for groundwater charges. Great Oaks states the differences in ORA's and Great Oaks' final estimate is based on updated information Great Oaks provided in the hearing, which indicates that the Santa Clara Valley Water District will increase its groundwater charge in TY 2003. (Exhibit 14.) ORA states the difference is based on calculation methodology. It would have been reasonable to accept the updated estimate provided by Great Oaks during the hearing. However, subsequent to submission of this proceeding, we approved a 13.72% revenue increase requested by Great Oaks to offset a pump tax increase effective July 1, 2003, in Resolution W-4423. We incorporate that increase in this decision. We decline to adopt Great Oaks' proposal to inflate those rates to 2004 levels and follow ORA's recommendation to exclude that inflation. Great Oaks did not justify inflating those rates. In addition, in D.03-06-072 we determined that balancing account-related increases only should be granted if the utility's rate of return does not exceed authorized levels. Forecasting future water supply increases in this GRC would subvert that review process.[3] Great Oaks can use the processes adopted in D.03-06-072 to mitigate effects of 2004 increases.

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[2] In TY 2003, management compensation increases will range from 7% to 47%, and field and office compensation increases will range from 25% to 67%.

[3] Similarly, we reject Great Oaks' and ORA's proposal to use forecasted costs of purchased power for TY 2003 and TY 2004. Instead, we adopt current rates. Neither

Footnote continued on next page

(c) Transmission and Distribution Supervision and Engineering Expense

Great Oaks' and ORA's estimates for transmission and distribution supervision and engineering expense differ by $6,762 in TY 2003 and $6,934 in TY 2004 due to ORA's disallowance of $19,348 recorded in 2000 for updating Great Oaks' system maps as a nonrecurring expense. General Order (GO) 103 requires utilities to prepare and keep current system maps. (GO 103, ¶ I.10.1.) Updating system maps is a required recurring expense and Great Oaks' estimates properly include the expense. We will approve Great Oaks' estimate for transmission and distribution supervision and engineering expense.

(d) Hydrant Maintenance

Great Oaks requests recovery of $100,000 for hydrant maintenance expense in TY 2003 and TY 2004 to assume responsibility for approximately 1,200 City of San Jose hydrants. ORA's estimate is $18,618 in TY 2003 and $18,860 in TY 2004, and is based on the Commission-approved expense of $15.52 per hydrant for San Jose Water Company that similarly assumed responsibility for the City of San Jose hydrants. Great Oaks states that San Jose Water Company has found the City's hydrants were poorly maintained. In addition, Great Oaks contends San Jose Water Company actually received $49.56 per hydrant, not $15.52.

We approved a rate increase for San Jose Water Company for assuming responsibility for the City's hydrants in the amount of $580,746, including $577,918 for increases in hydrant maintenance, and the remainder for

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party presented any justification for inflating rates to cover anticipated increases and using forecasted costs would subvert D.03-06-072's review process.

local franchise tax and uncollectibles. (Resolution W-4374.) We will approve the same amount, $49.31 per hydrant in maintenance costs, for Great Oaks.

(e) Customer Records and Collection

Great Oaks and ORA agree on estimates for customer records and collection. Great Oaks states that ORA has not recalculated the expense with ORA's escalation factors. Since ORA and Great Oaks agree on this expense, we will approve Great Oaks' estimates of $135,682 for TY 2003 and $139,128 for TY 2004.

(f) New 401K Plan

Great Oaks plans to replace its existing pension plan with a Safe Harbor 401K Plan and seeks full funding of $358,500 in TY 2003 and $414,875 in TY 2004. ORA states Great Oaks has neither described its 401K proposal nor substantiated the increase in expense it would require, so the Commission should reject the expense. ORA notes that Great Oaks currently maintains a fully funded pension plan and is not required to make contributions to it. Great Oaks states the new plan is necessary to make Great Oaks' benefits competitive with those of neighboring water companies, although Great Oaks maintains that the 401K plan will still be less than pension plans at those companies.

Great Oaks provides scant justification for the increased funding associated with the 401K plan. We have disallowed a costly 401K plan that was not well-justified. (*In Re Pacific Bell*, D.86-07-026, 20 CPUC 2d 237.) Because there is insufficient support for this change in benefits, we will not require ratepayers to fund it.

(g) Regulatory Commission Expenses

ORA agrees with Great Oaks' original regulatory expense request of $25,000 per year for three years. Great Oaks increased its request during the hearings to $50,000 per year for three years based on the costs of litigating its GRC, including what Great Oaks characterizes as excessive data requests, assistance provided to ORA in reviewing the application, additional costs of legal representation, and reconciling data transfer errors. ORA believes Great Oaks' lack of advance preparation caused the increased costs and required ORA to request additional information.

We have not encouraged late-presented estimates for higher GRC costs, because a one-time increase in costs is not typical. (D.03-02-030, 2003 Cal PUC LEXIS 1221 **15-17.) In addition, the amount requested exceeds what we have approved for increased costs for a larger water company. (*Id.*) Finally, presenting the requested increase at hearings precluded any analysis of the request by ORA. Given the timing of the requested increase, we will not approve it. However, Great Oaks need not incur the additional expense associated with further correction of the data transfer errors. Great Oaks has corrected those errors in this proceeding and need not revise its annual reports.

(h) Legal Fees Relating to City of San Jose Litigation

Great Oaks requests recovery of forecasted expenses related to its litigation with the City of San Jose over water contamination issues. ORA objects because Great Oaks has not justified this expenditure with any description, analysis, or need for the litigation, nor has it shown the probability of prevailing in such a lawsuit. Instead, ORA recommends these expenses should not be authorized but could be tracked in a memorandum account and recovered in the future when Great Oaks demonstrates it has incurred the legal fees and adequately justifies them. ORA's recommendation is consistent with the process we have used for future legal expenses. We have required companies to track legal fees in memorandum accounts in order to review the amounts incurred and the outcome of the litigation. (*Re San Gabriel Water Co.*, D.02-10-058, Cal PUC LEXIS 727 **22-23.) We will require Great Oaks to similarly record these amounts for any future recovery.

(i) Public Relations Expense

Great Oaks requests $24,000 for public relations expense for each of test years 2003 and 2004. ORA states Great Oaks has not demonstrated the need for or benefit of the consultant who will advise on preparing brochures and other material for customer consumption and on how the company should relate to developers, local business, and governmental agencies. ORA recommends the Commission disallow this expense. Great Oaks states it is more cost effective to hire a consultant than to hire an employee. Great Oaks believes governmental and public relations are a vital function.

Great Oaks' salary study states its Chief Operating Officer has special qualifications in public relations, among other areas, in justification for increasing his salary. (Exhibit 13.) Because Great Oaks has in-house expertise in that area, current employee resources should meet any ratepayer interest in public relations expenditures. We disallow Great Oaks' requested public relations expense.

(j) Directors' Fees

Great Oaks requests Board of Directors' fees of $36,000 for each test year, an increase in the annual payment from $6000 to $8000 per year for each director and an allowance of $1000 per director for each quarterly directors' meeting. Currently there is no per meeting allowance. Great Oaks states comparable compensation varies from $6000 to $16,000 in annual payments plus $1000 per meeting. ORA recommends that only the one outside director receive $500 for each meeting, for a total of $2000 per year, and does not recommend any annual payment. Because the other directors are either owners of the company or a salaried employee, ORA believes they receive adequate compensation from the opportunity to earn on their investment or from salaried employment.

We concur that ratepayers should not additionally "compensate" employees or owners for annual director's fees and will limit recovery of the $8,000 fee to the outside director. We lack information on the amount of time required for directors' meetings and will limit recovery to $500 per director for each meeting.

(2) Rate Base

Great Oaks states that it has submitted full support for its rate base increase requests and that it should be permitted to record those capital items in rate base. Great Oaks requests $5,290,200 for TY 2003 and $1,257,350 for TY 2004. ORA recommends no allowance for most plant addition expenditures, because Great Oaks has not justified the need for these items. ORA issued its data requests in early January but received the bulk of Great Oaks' responses in late February, during the week before ORA's report in this proceeding was due. Thus, ORA had little time to evaluate all of this information. At the conclusion of hearings, the assigned ALJ ordered Great Oaks to furnish the information requested by ORA's witness at the hearing. ORA reviewed the additional information Great Oaks filed in this proceeding but still finds it lacks justification. ORA recommends $540,000 for TY 2003 and $50,400 for TY 2004. We discuss their differences below.

ORA recommends that Great Oaks be permitted to recover the costs for only one project, and to do so by filing an advice letter when the project is completed and placed in service. Great Oaks believes the advice letter process is unnecessary and administratively wasteful. We have used the advice letter process to add plant to rates. (*See San Gabriel Valley Water Co., supra* at *7.) We have permitted those advice letters to be effective on filing if the costs conform to those approved in our order. (*Re Suburban Water Systems*, D.03-05-078, 2000 Cal PUC LEXIS 938 **64-65.) We adopt that general approach here; we next discuss issues related to specific projects.

(a) Coyote Creek Pump Station Project

Great Oaks states the Coyote Creek Pump Station Project will pump up to 1000 gallons per minute into Great Oaks' Zone II. Zone II requires the backup source of supply because its sole present supply main is almost 40 years old and there is no alternative supply source. Great Oaks requests $120,000 for TY 2003 only but states the cost may be greater because Great Oaks will need to purchase a small plot of private land to construct the project. ORA recommends disallowing this project.

We have insufficient information to approve the cost of this project. This finding does not preclude Great Oaks' filing an advice letter to add this plant to rates, but Great Oaks must follow normal advice letter procedures for the request.

(b) County Park Project

The County Park Project, for which Great Oaks has requested $525,000 for TY 2003 only, has three portions, 2,000 linear feet of pipeline, 800-900 linear feet of pipeline that will serve an office building, hotel, and sports complex, and a connection from an existing underground main. The developer will pay approximately $90,000 of the $150,000 estimate for the third portion.

The first two portions will cost approximately $300,000 and $75,000, respectively. Great Oaks states that the project will provide fire protection for the development and also increased volume and pressure, reducing a supply deficit, friction loss, and pumping pressure. ORA recommends disallowing this project.

We have insufficient information to approve the cost of this project. This finding does not preclude Great Oaks' filing an advice letter to add this plant to rates, but Great Oaks must follow normal advice letter procedures for the request.

(c) Edenvale/Hayes Project

Great Oaks requests $160,000 for TY 2003 only for the project, which consists of a 1,580-foot long main extension. The Hayes Mansion will bear $90,000 of the total cost as a contribution. The project mainly will benefit the convention center and hotel, which lacks sufficient water service, and will provide fire protection to those structures. ORA recommends disallowing the project.

We have insufficient information to approve the cost of this project. This finding does not preclude Great Oaks' filing an advice letter to add this plant to rates, but Great Oaks must follow normal advice letter procedures for the request.

(d) Santa Teresa Project

Great Oaks requests approval for $1,838,000 in TY 2003 and $232,000 in TY 2004 for this main extension of approximately 19,000 feet connecting Great Oaks' main service area with the New Well Project and with a remote portion of its service area. ORA recommends that Great Oaks be permitted to recover the costs of this project via the advice letter process when the project is completed.

We will approve the expenditures requested by Great Oaks but will require Great Oaks to file an advice letter for the approved costs when the Santa Teresa Project is placed in service. The advice letter will be effective on filing if it conforms to this order. If not, the Water Division will prepare a resolution that adjusts rates appropriately.

(e) New Well and Pumping Equipment

Great Oaks requests $400,000 in TY 2004 only to acquire land and to construct and equip with a pump a new well. This request appeared in the appropriate accounts but did not appear in the application due to a defective computer link. (Exhibits 8 and 2.) The project will provide a new source of uncontaminated potable water and will supply water to a main service area that has a higher pump tax rate. The project potentially could save ratepayers in the main Great Oaks' service area approximately $215 per acre foot and a total of about $400,000 per year in pump tax savings by the next rate case cycle. ORA recommends disallowing this project.

Because the project is a part of the Santa Teresa project, which we approve, and because it could result in savings, we will approve the expenditure and will require Great Oaks to file an advice letter when the project is placed in service. In that advice letter, Great Oaks also shall make necessary adjustments to rates to reflect the savings associated with the project.

(f) Additional 4,290 Feet of Pipeline

Great Oaks requests $429,000 in TY 2004 only for additional pipeline required because of its inability to acquire City of San Jose facilities. This project will link portions of the Santa Teresa pipeline and is necessary to supply water from the New Well Project to Great Oaks' main distribution system. However, Great Oaks states its negotiations with the City of San Jose to acquire pipeline that would serve the same purpose are ongoing and may yet result in the acquisition. Great Oaks states it will discount this project, if approved, by the cost of the City's facilities, if acquired. ORA recommends disallowing this project.

We will approve this expenditure, subject to the condition that the cost of this project be discounted if Great Oaks acquires the City's facilities. The pipeline, whether constructed or purchased, is a necessary component of the approved Santa Teresa Project and should be approved. Great Oaks must file an advice letter for the approved costs when the pipeline is placed in service.

(g) Hydrant Replacement

Great Oaks requests approval of $40,000 in TY 2003 and TY 2004 for capital expenditures to replace City of San Jose hydrants for which it is assuming responsibility. ORA states it can find no basis for Great Oaks' request. Great Oaks states its request is based on San Jose Water Company's recent experience with City hydrants that have needed replacement, because they simply do not work. Great Oaks provides an attachment to San Jose Water Company's Advice Letter 336, which notes costs for vehicles, equipment, maintenance, and repairs, but does not specify capital expenditures.

Although hydrant replacement may be necessary, we have insufficient information to approve the amount requested by Great Oaks. This finding does not preclude Great Oaks' filing an advice letter to add hydrant replacement to rates.

(h) SCADA System Upgrades

Great Oaks requests $114,000 for SCADA (remote metering and control system) upgrades for TY 2003. Great Oaks states the SCADA system is eight years old and the manufacturer no longer supports key elements. Great Oaks seeks to upgrade the system by replacing internal electric modules and associated parts in each of its 21 on-site remote SCADA boxes due to changes in voltage requirements. The cost is $4,000 per site for a total of $84,000. In addition, new flow meters at two tank sites, Cla Valve modifications, and software programming are necessary, at a cost of $30,000. ORA did not have sufficient information to analyze Great Oaks' request.

Although we have only Great Oaks' estimate of the costs of upgrading its SCADA system, replacement of obsolete equipment is a necessary capital expenditure and we will approve the upgrades.

(i) New SCADA Sites

Great Oaks requests $22,000 in TY 2003 for two new SCADA monitoring sites so that the SCADA system can be used to control and monitor the new pump station on Coyote Road, as well as the new well in Coyote Valley. ORA recommends a total disallowance. Because we did not approve recovery at this time of the projects the SCADA system supports, we will require Great Oaks to request the amount for the new SCADA monitoring sites in the advice letters requesting approval of expenditures for the projects.

(j) Personal Computer Replacements

Great Oaks requests $5,000 for each of Test Years 2003 and 2004 for personal computers. Great Oaks states its 14 personal computers have an average age of four years. Great Oaks depreciates these computers over their useful life of five years and requests the expenditure in order to upgrade the computers. ORA recommends disallowing this expenditure, because Great Oaks did not supply sufficient information to support its request.

Replacement of computers is a normal business expense. We will allow Great Oaks' expenditure for personal computers.

(k) Vehicles

Great Oaks seeks to replace one supervisor's truck at a cost of $30,000 in TY 2003, which ORA opposes. Great Oaks also seeks to replace two Rangers ($30,000) and one supervisor's truck ($30,000) in TY 2004. ORA opposes the expenditures, because it lacks sufficient supporting information. Great Oaks states that the expenditures are for the replacement of long-exhausted vehicles, including a vehicle from 1978, that need frequent maintenance.

Replacement of vehicles is a normal business expense. We will approve the expenditures for the two supervisor's trucks and the two Rangers.

(3) Cost of Capital

Great Oaks requests a rate of return of 9.42% for TY 2003 and 9.73% for TY 2004. ORA recommends a rate of return of 8.57% for TY 2003 and 8.89% for TY 2004. Great Oaks and ORA agree to use the imputed capitalization of 34% debt and 66% equity adopted in D.93-10-046, Great Oaks' last GRC. Great Oaks and ORA also agree on the cost of long-term debt, 7.20% for TY 2003 and 8.12% for TY 2004.

ORA recommends 9.28% for return on equity (ROE), while Great Oaks requests 10.95%. ORA's recommended ROE of 9.28% is based on an average of two models, the Discounted Cash Flow (DCF) and Risk Premium (RP) models. Great Oaks relies solely on the RP method. Great Oaks adopted ORA's RP figure, because ORA's method used a more rigorous calculation thn Great Oaks' method.

Great Oaks questioned ORA's use of an average of this RP figure with a DCF figure of 8.00%, because Great Oaks does not believe that the DCF method is appropriate for closely held non-public corporations such as Great Oaks. It believes there is no basis for using a simple average of the RP and DCF models. Great Oaks asserts that the owners of small public utility water companies base their investment decisions on whether or not the increased risk associated with an equity investment makes it worthwhile to reinvest in utility facilities as opposed to corporate bonds or similar fixed investments. The RP method more accurately measures that risk.

ORA states these models are applied to a comparable group of companies in order to average out any company-specific biases. The DCF and RP models require market-based data. Therefore, they are applied to a comparable group of water utilities that are publicly traded and receive 70% of their revenue from water operations. (Exhibit 15.) ORA states two decisions, *Re Del Este Water Co.,* D.91-12-073, 42 CPUC 2d 492, 492-496, and *Re Del Este Water Co.,* D.89-11-063, 33 CPUC 2d 517, 521, support the use of a comparable company and a DCF to determine the appropriate ROE for a company that was not publicly traded.

Although we have relied on the DCF model to compute ROE for comparable companies when the utility is not publicly traded, we have done so when presented with a range of values that closely compared to other methods. Here there is a 295 basis point discrepancy between the DCF and RP models. We recently viewed such a disparity as problematic when requested to adopt an average of the two results. (*Re Suburban Water Co.*, D.03-05-078, 2002 Cal. PUC Lexis 938 * 53.) We decline to adopt a simple average. Because ORA and Great Oaks agree on ORA's RP Model, we will accord more weight to that result and adjust ORA's ROE upwards by 50 basis points to 9.78%.

(4) Memorandum Account Amortization

Great Oaks requests recovery of undercollections in its memorandum and balancing accounts for groundwater charges and purchased power that have accumulated since November 29, 2001. ORA recommends that this issue be resolved according to the procedures adopted in Rulemaking (R.) 01-12-009.

In D.03-06-072, we adopted procedures for resolving undercollections since November 29, 200l. We required water utilities to file advice letters seeking account review for November 29, 2001 through December 31, 2002, within 90 days from the mailing date of D.03-06-072. This decision also specifies the information that the utility must submit, together with the required analysis to perform and the calculation method. Because we established procedures for resolving this issue in R.01-12-009, we will not address the amortization of the undercollection in this proceeding. Subsequent to submission of this proceeding, we approved a 3.11% revenue increase to recover these undercollections in Res. W-4424.

(5) MTBE Contamination Proceeds

Great Oaks proposed split net contamination proceeds, a total to date of $451,016, excluding interest, as one half to Contributions in Aid of Construction and one half into rate base earning a return. We approved a similar split in D.93-09-077, Great Oaks' last GRC, which adopted a settlement agreement. ORA objected to the proposal, because Great Oaks did not establish a memorandum account as ordered in Res. W-4094. Great Oaks has booked the proceeds in deferred accounts. ORA recommended that Great Oaks establish a memorandum account, that the account be considered for amortization at the same time Great Oaks submits its Groundwater Charges and Purchased Power memorandum accounts for amortization. In response to ORA's position, Great

Oaks modified its position to request that 100% of the net proceeds be reinvested in rate base.

Great Oaks initiated litigation to address contamination of a well caused by fuel leaks at Chevron's and Tosco's service stations. Great Oaks received $735,000 in settlements and incurred $283,984 in litigation expenses and repair costs for the affected well. By all measures, Great Oaks' litigation was successful. Although we required water utilities to track litigation expenses in memorandum accounts in Res. W-4094, we have not found a regulatory distinction between deferred and memorandum accounts for cost-tracking purposes. (Re So. Cal. Water Co., D.90-11-002, 1990 Cal. PUC LEXIS 987 *28; Res. E-3676, 2000 Cal. PUC LEXIS 456.) Thus we find no basis for adopting ORA's recommendation that Great Oaks shift the proceeds in the deferred account to a memorandum account and will approve Great Oaks' original proposal to split the net contamination proceeds as one half to Contributions in Aid of Construction and one half to shareholders. In the future, Great Oaks should establish a memorandum account for water litigation proceeds.

4. Comments on Proposed Decision

The proposed decision was filed with the Commission and served on all parties in accordance with Section 311(d) of the Public Utilities Code and Rule 77.1 of the Rules of Practice and Procedure. Comments were received from ______________, and reply comments were received from _____________.

5. Assignment of Proceeding

Geoffrey F. Brown is the Assigned Commissioner and Janice L. Grau is the assigned ALJ in this proceeding.

Findings of Fact

1. Great Oaks and ORA agree on many results of operations figures.

2. Great Oaks has experienced turnover in management and field personnel.

3. Great Oaks updated its groundwater charge estimate during the hearings due to Santa Clara Valley Water District increases for 2003. Resolution W-4423 authorizes a 13.72% revenue increase to offset a July 1, 2003 pump tax increase.

4. Great Oaks and ORA agreed to use forecasted costs of purchased power for TY 2003 and TY 2004.

5. General Order 103 requires utilities to prepare and keep system maps current.

6. The Commission approved $49.31 per hydrant in maintenance costs for San Jose Water Company.

7. Great Oaks currently maintains a fully funded pension plan and is not required to make contributions to it.

8. During hearings Great Oaks increased its request for regulatory expense from $25,000 to $50,000.

9. Great Oaks corrected data transfer errors contained in its annual reports in this proceeding.

10. Great Oaks has requested future legal expenses related to litigation with the City of San Jose over water contamination issues.

11. Great Oaks requests public relations expense for a consultant’s fees. Great Oaks’ Chief Operating Officer has special qualifications in public relations.

12. Employee directors receive compensation from Great Oaks and owner directors have the opportunity to earn on their investment.

13. Great Oaks provided insufficient information to approve its request for hydrant replacement at this time.

14. Great Oaks requests upgrading its SCADA system and replacing obsolete equipment.

15. Great Oaks requests replacing computers over their useful life of five years.

16. Great Oaks requests replacement of vehicles that need frequent maintenance.

17. Great Oaks requests splitting the net proceeds from water contamination litigation, a total to date of $451,016, excluding interest, booked in deferred accounts, as one half to Contributions in Aid of Construction and one half into rate base.

18. Resolution W-4094 authorizes all water utilities to establish a memorandum account for water contamination litigation expenses.

19. The Commission has used the advice letter process to add plant to rates.

20. ORA had little time to analyze data request responses furnished by Great Oaks and found additional information furnished by Great Oaks insufficient to permit ORA to make a recommendation other than disallowance for several plant additions.

21. ORA's recommended return on equity is derived from averaging 10.56% based on the RP model and 8.00% based on the DCF model.

22. Great Oaks adopted ORA's RP figure of 10.56%.

Conclusions of Law

1. It is reasonable to authorize Great Oaks to implement the rate changes Great Oaks has justified.

2. It is reasonable to decline to authorize rate increases at this time where Great Oaks has provided insufficient information to justify the increase.

3. It is reasonable and consistent with D.03-06-072 to decline to approve forecasted groundwater charges and purchased power costs.

4. Great Oaks need not file revised annual reports to correct data transfer

errors.

5. It is reasonable to limit annual director fees to outside directors.

6. It is reasonable to permit Great Oaks to divide equally the net proceeds from water contamination litigation between Contributions in Aid of Construction and shareholders.

7. It is reasonable to require Great Oaks to file an advice letter to add plant to rates when proposed projects are placed in service.

8. It is reasonable to adopt a Return on Equity of 9.78%.

9. This decision should be made effective immediately to allow Great Oaks an opportunity to earn the return found reasonable for it in TY 2003.

O R D E R

IT IS ORDERED that:

1. Great Oaks Water Company (Great Oaks) is authorized to file in accordance with General Order 96, and make effective on not less than five days' notice and not earlier than January 1, 2003, the revised tariff schedules for 2003 shown in Appendix B to this order and to concurrently cancel its present schedules for such service. The revised tariff schedules shall apply to service rendered on and after their effective date.

2. Great Oaks is authorized to file advice letters seeking Commission authorization for rate offsets for the following capital projects when each has been completed and placed in service, no earlier than the year indicated and at costs not to exceed those indicated:

   a. Santa Teresa Project. Test Year (TY) 2003, maximum cost of $1,838,000, and TY year 2004, maximum cost of $232,000.

   b. New well and pumping equipment. TY 2004, maximum cost of $400,000.

c. Additional 4,210 feet of pipeline. TY 2004, maximum cost of $429,000.

3. The summaries of earnings presented in Appendix A to this order and the underlying quantities and calculations included in Appendix D are adopted.

4. Great Oaks’ requests in Application 02-11-048 are granted as set forth abvoe, and in all other respects are denied.

5. Application 02-11-048 is closed.

This order is effective today.

Dated _______________________, 2003, at San Francisco, California.

APPENDIX A
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Table 1

Revenue Requirement Increases

	2003		2004	
	$ (000)	%	$ (000)	%
Great Oaks Application Request Revised Request	 2,811.4 2,138.4	 35.43 26.95	 977.7 849.6	 9.03 8.19
ORA Initial Recommendation Revised Recommendation	 1,031.1 1,383.0	 12.98 17.43	 322.0 347.0	 3.59 3.72
ORA (Great Oaks Calculation)* Initial Recommendation Revised Recommendation	 708.8 181.4	 8.93 1.98	 278.5 291.6	 3.20 3.11
Adopted	482.1	5.28	000.7**	0.008

* In its April 10, 2003 Comments on Joint Comparison Exhibit, Great Oaks stated that ORA's calculations contained simple errors that ORA did not correct in the comparison exhibit

** This revenue-requirement increase has no impact on rates.